INDEX

	Page
Opinion below	1
Jurisdiction	1
Questions presented	1
Statute and regulation involved	2
Statement	5
Argument	6
Conclusion	12

CITATIONS

Cases:

Bass v. *United States*, 324 F. 2d 168 — 12

Ira Haupt and Company, 23 S.E.C. 589 — 7, 11

Ricks v. *United States*, No. 20,919, C.A.D.C., decided December 23, 1968 — 11, 12

S.E.C. v. *Ralston Purina Co.*, 346 U.S. 119 — 9

Sproles v. *Binford*, 286 U.S. 374 — 12

United States v. *Petrillo*, 332 U.S. 1 — 12

United States v. *Raines*, 362 U.S. 17 — 12

United States v. *Re*, 336 F. 2d 306, certiorari denied, 379 U.S. 904 — 12

United States v. *Wurzbach*, 280 U.S. 396 — 11, 12

Statutes and regulations:

Securities Act of 1933, 48 Stat. 74ff, 15 U.S.C. 77:

Section 2(11), 15 U.S.C. 77b — 2, 7

Section 4, 15 U.S.C. (1958 ed.) 77d — 2, 7, 10

Section 4, 15 U.S.C. (1964 ed.) 77d — 7, 8, 10, 11

Section 5(a), 15 U.S.C. 77e(a) — 2, 3, 5, 10, 11

15 U.S.C. 77f(11) — 3, 7

78 Stat. 580 — 3

17 C.F.R. 230.154 — 3, 4

Miscellaneous:

H. Rep. No. 85, 73d Cong., 1st Sess. — 7, 9, 10

1 Loss, *Securities Regulation* (2d ed. 1961) p. 700 — 9, 10

336-763—69

In the Supreme Court of the United States

OCTOBER TERM, 1968

No. 1057

LOUIS E. WOLFSON AND ELKIN B. GERBERT, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the court of appeals (Pet. App. A) is not yet reported.

JURISDICTION

The judgment of the court of appeals was entered on December 27, 1968. A petition for rehearing was denied on January 23, 1969. The petition for a writ of certiorari was filed on February 17, 1969. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether petitioners' sales of unregistered stock were exempt transactions under 15 U.S.C. 77d(1) or (4).

2. Whether the statute is unconstitutionally vague.

STATUTE AND REGULATION INVOLVED

The Securities Act of 1933, 48 Stat. 74ff, 15 U.S.C. 77, as in effect at the date pertinent to this prosecution provided in pertinent part:

Section 5(a), 15 U.S.C. 77e(a):

> Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—
>
> (1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or
>
> (2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

Section 4, 15 U.S.C. (1958 ed.) 77d:

> The provisions of section 77e of this title shall not apply to any of the following transactions:
>
> (1) Transactions by any person other than an issuer, underwriter, or dealer; transactions by an issuer not involving any public offering; * * *
>
> (2) Brokers' transactions, executed upon customers' orders on any exchange or in the open or counter market, but not the solicitation of such orders.[1]

[1] An amendment in 1964 (78 Stat. 580) in essence transferred subsection (2) of section 77(d) to subsection (4) and divided the provisions of subsection (1) into the three preceding subsections without substantive change.

Section 2(11), 15 U.S.C. 77b(11):

> The term "underwriter" means any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking, but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission. As used in this paragraph the term "issuer" shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer.

17 C.F.R. 230.154 provides in part:

> (a) The term "brokers' transactions" in section 4 (4)[2] of the act shall be deemed to include transactions by a broker acting as agent for the account of any person controlling, controlled by, or under common control with, the issuer of the securities which are the subject of the transactions where:
>
> (1) The broker performs no more than the usual and customary broker's function,
>
> (2) The broker does no more than execute an order or orders to sell as a broker and receives no more than the usual or customary broker's commission, and the broker's principal, to the knowledge of the broker, makes no

[2] See note 1, *supra*.

payment in connection with the execution of such transactions to any other person,

(3) Neither the broker, nor to his knowledge his principal, solicits or arranges for the solicitation of orders to buy in anticipation of or in connection with such transactions, and

(4) The broker is not aware of circumstances indicating that his principal is an underwriter in respect of the securities or that the transactions are part of a distribution of securities on behalf of his principal.

(b) For the purpose of paragraph (a) of this section, the term "distribution" shall not apply to transactions involving an amount not substantial in relation to the numbers of shares or units of the security outstanding and the aggregate volume of trading in such security. Without limiting the generality of the foregoing, the term "distribution" shall not be deemed to include a sale or series of sales of securities which, together with all other sales of securities of the same class by or on behalf of the same person within the preceding period of six months, will not exceed the following:

(1) If the security is traded only otherwise than on a securities exchange, approximately one percent of the shares or units of such security outstanding at the time of receipt by the broker of the order to execute such transactions or (2) if the security is admitted to trading on a securities exchange the lesser of approximately (i) one percent of the shares or units of such security outstanding at the time of receipt by the broker of the order to execute such transactions or (ii) the largest aggregate reported volume of trading on securities ex-

changes during any one week within the four calendar weeks preceding the receipt of such order.

STATEMENT

After a jury trial in the United States District Court for the Southern District of New York, petitioners were convicted on eighteen counts of selling (and in one count of conspiring to sell) a large block of Continental Enterprises, Inc. stock owned by them or members of the Wolfson family, without the stock being registered, in violation of 15 U.S.C. 77(e). Petitioner Wolfson was sentenced to imprisonment for one year and a fine of $100,000; petitioner Gerbert was sentenced to six months' imprisonment and a fine of $50,000. The court of appeals affirmed (Pet. App. A).

The facts are not in dispute. Petitioners, together with immediate members of Wolfson's family, owned approximately 1,150,000 shares of Continental Enterprises stock, or more than 40 percent of the total number of outstanding shares; the remaining shares were publicly owned. Between August 1, 1960, and January 31, 1962, petitioner Wolfson sold more than 404,000 shares of Continental through six brokerage houses, petitioner Gerbert sold 53,000 shares through three brokerage houses, and various members of the Wolfson family (including family trusts) sold 176,675 shares through six brokerage houses (Pet. App. A–2). These, in aggregate, were more than 25 percent of the outstanding number of shares and more than 55 percent of petitioners' holdings. Petitioner Wolfson, although not an officer or director of Continental,

was its "guiding spirit in that the officers of the corporation were subject to his direction and control and that no corporate policy decisions were made without his knowledge and consent" (Pet. App. A–2). Petitioner Gerbert was a director of Continental and petitioner Wolfson's "right hand man" (*ibid.*).[3] No registration statement was in effect as to Continental, whose stock was traded on the over-the-counter market.

Petitioners' defense, by which they attempted to show lack of intent to violate the law, was that they were unaware of any registration requirement with respect to stock of unlisted companies and that, operating at their own high levels of corporate finance, they could not be concerned about such "details" (Pet. App. A–3; Pet. 5–6; see G.A. 60a–61a, 112a, 117a–118a).[4] The Government introduced evidence tending to rebut this "defense" (Pet. App. A–3.)[5]

ARGUMENT

1. Petitioners were clearly in control of Continental and their sale of 25 percent of its outstanding stock was clearly a distribution effected without registration. They contend, however, that the distribution was

[3] Thus, for example, all of the sell orders for Wolfson's stock were placed by Gerbert.

[4] "G.A." refers to the government's appendix in the court of appeals, a copy of which has been lodged with the Clerk of this Court.

[5] Petitioner Wolfson, *inter alia*, was shown to have attended a meeting in 1950 lasting over two hours with the Regional Administrator of the Washington, D.C., office of the Securities and Exchange Commission, in which the registration requirements of the Securities Act of 1933 applicable to controlling persons were explained in great detail. See G. Ex. 21.

exempt from the registration requirement because they acted through brokers who, if unaware of the circumstances of the distribution, would under Section 4(4) and implementing Rule 154 (*supra*) not have violated the law for their part in the transaction. This argument was properly rejected by the courts below. As the Securities and Exchange Commission made clear in its 1946 decision in *Ira Haupt and Company,* 23 S.E.C. 589, 601–602, Section 4(1) of the Act (15 U.S.C. 77d(1)), when read in conjunction with Section 2(11) (15 U.S.C. 77f(11)), establishes that

> [W]henever anyone controlling an issuer makes a public distribution of his holdings in the controlled corporation by selling through another person acting for him in connection with the distribution, the sales by which the distribution is accomplished are transactions by an underwriter which are subject to the registration requirements. Applied to such transactions by which substantial quantities of securities are disposed of to the public, the registration requirement is consistent with and calculated to further the general purpose of the Act to provide investors with pertinent information as a means of self-protection. The legislative history of the Act strongly sustains this conclusion.

The legislative history to which the Commission there referred is H. Rep. No. 85, 73d Cong., 1st Sess., pp. 13–14 which, in referring to the definition of underwriter in section 2(11), states:

> The last sentence of this definition, defining "issuer" to include * * * persons controlling the issuer, has two functions * * *. Its second

> function is to bring within the provisions of the bill redistribution whether of outstanding issues or issues sold subsequently to the enactment of the bill. *All the outstanding stock of a particular corporation may be owned by one individual or a select group of individuals. At some future date they may wish to dispose of their holdings and to make an offer of this stock to the public. Such a public offering may possess all the dangers attendant upon a new offering of securities.* Wherever such a redistribution reaches significant proportions, the distributor would be in the position of controlling the issuer and thus able to furnish the information demanded by the bill. *This being so, the distributor is treated as equivalent to the original issuer and, if he seeks to dispose of the issue through a public offering, he becomes subject to the act.* The concept of control herein involved is not a narrow one, depending upon a mathematical formula of 51 percent of voting power, but is broadly defined to permit the provisions of the act to become effective wherever the fact of control actually exists. [Emphasis added.]

Thus the brokers in this case were, wittingly or unwittingly, acting as underwriters. The transactions involved were accordingly not within the exemption from registration which Section 4(1), 15 U.S.C. 77d(1), provides for "transactions by any person other than an issuer, underwriter, or dealer."

The *Haupt* decision in 1946 was not, as petitioners suggest, a basic change in the interpretation of the Act as applied to distribution by controlling persons.

It is true that before *Haupt* the Commission's approach had been that, if the broker were exempt, the affiliate of the issuer was exempt because he was not an issuer, underwriter or dealer. 1 Loss, *Securities Regulation* (2d ed., 1961), p. 700. However, as Professor Loss points out, the caveat was always added that a broker engaged in distributing any block of securities would probably be compelled to perform functions beyond those normally exercised by brokers, *op. cit.* p. 701. Thus it was assumed that distributions by controlling persons would in practice require registration. It was because this assumption proved incorrect in light of market conditions that the Commission re-examined the question in the *Ira Haupt* case.

As Professor Loss has stated, *op. cit.* at p. 703, "it could not be convincingly argued for a moment that Congress did not intend this kind of distribution to be subject to the registration requirement." The purpose of the registration requirement was to make available to the buyer of stock material information possessed by the seller in situations in which the seller ordinarily would have more information about the company than the buyer. A distribution by a controlling person made through a broker is likely to involve precisely that situation, and the courts below properly took account of this legislative purpose in holding that petitioners' distribution of the unregistered stock violated the Act. Cf. *Securities and Exchange Commission* v. *Ralston Purina Co.*, 346 U.S. 119, 124; H. Rep. No. 85, 73d Cong., 1st Sess., pp. 1–3, 13–14.

The same considerations refute petitioners' argument that, if the brokers were not shown to be aware that the sales were a distribution by a controlling person, they could not be acting as underwriters because they would not themselves violate the Act. It does not follow that, because the broker might not be a violator, he could not unwittingly be an underwriter.[6] As Professor Loss has said (*op. cit.* p. 706), if the seller "falsely represents to [the broker] that there have been no such sales and the broker has no reasonable ground to believe that there have been, he would still seem to be an 'underwriter' so as to destroy the exemption under the first clause of 4(1) for the selling customer.'" Or, as the court below succinctly put it (Pet. App. A–4 to A–5):

> [15 U.S.C. 77(d)(4)] was designed only to exempt the brokers' part in security transactions. * * * Control persons must find their own exemptions.

This petitioners are unable to do. Whether the brokers knew it or not, petitioners, as controlling persons, were using them as underwriters.[7]

---

[6] Professor Loss considered criminal prosecution of a broker who was an unwitting underwriter "inconceivable as a practical matter." *Op. cit.* p. 706. He expressed no such doubts with respect to the liability of a knowing affiliate of the seller.

[7] The legislative history of the broker's exemption in Section 4(4)) indicates that its primary purpose was to permit ordinary investors to sell their stock through brokers in certain situations in which exemption from the registration requirement would be available to the seller under Section 4(1) but no exemption would otherwise be available to the broker. See H. Rep. No. 85, 73d Cong., 1st Sess., p. 16.

2. The considerations discussed above also answer petitioners' argument that Sections 4 and 5 are too vague either to serve as an objective guide to fair adjudication or to give fair warning of the proscribed conduct. A statute regulating the sale of securities is necessarily more complicated than a statute punishing simple theft. When petitioners sold the stock, the registration requirements of the Act had been in existence for almost thirty years, and the Commission's interpretation in the *Ira Haupt* case had been known for almost twenty. Whatever "fuzzy area" there may be with respect to the liability of innocent brokers acting for a person in control of an issuer (see Pet. 16 n. 17), there has, as noted above, been no real question that knowing distribution on the part of controlling persons is subject to the registration requirement of Section 5.

As to the adequacy of petitioners' notice and warning of proscribed conduct, we suggest, in the words of *United States* v. *Wurzbach,* 280 U.S. 396, 399, that "* * * no one not in search of trouble would feel any." This is particularly true in light of the long standing practice of the Commission's staff in furnishing advice, when requested, as to whether contemplated action would violate the Act. Moreover, petitioners could have avoided any problem by registering the securities. In any event, as the court below held, petitioners cannot properly rely on lack of notice in view of their defense that at their high management level they neither had notice, nor indeed were even aware of the statute. Cf. *Ricks* v. *United States* (No. 20,919A,

C.A.D.C.), decided December 23, 1968, set forth at Pet. App. D. Since petitioners claimed that they were ignorant of the registration requirement, they cannot urge that the allegedly ambiguous language of the statute led them to make sales they believed the Act did not cover. *Ricks, supra,* at Pet. App. D, D–5 to D–6; see, also, *United States* v. *Wurzbach,* 280 U.S. 396, 399; *United States* v. *Raines,* 362 U.S. 17, 21.[7]

CONCLUSION

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

ERWIN N. GRISWOLD,
Solicitor General.
WILL WILSON,
Assistant Attorney General.
BEATRICE ROSENBERG,
ROGER A. PAULEY,
Attorneys.

MARCH 1969.

[7] The court below also properly rejected petitioners' subsidiary contention that the concept of "control stock" was impermissibly vague (Pet. App. A–6). As the court pointed out in a previous decision upholding the definiteness of the term (*United States* v. *Re.* 336 F. 2d 306, 316 (C.A. 2), certiorari denied, 379 U.S. 904), the "meaning of 'control' under the act is no different than it is in normal everyday usage. 'The requirement of reasonable certainty does not preclude the use of ordinary terms to express ideas which find adequate interpretation in common usage and understanding.' *Sproles* v. *Binford.* 286 U.S. 374, 393 * * *." See, also, *United States* v. *Petrillo,* 332 U.S. 1, 7–8; *Bass* v. *United States,* 324 F. 2d 168, 173 (C.A. 8).

U.S. GOVERNMENT PRINTING OFFICE: 1969